



28 August 2009

Mr Chris Pattas
General Manager
Network Regulation South Branch
Australian Energy Regulator
GPO Box 520
Melbourne VIC 3000

by email: aer inquiry@aer.gov.au

Dear Mr Pattas,

RE: ETSA UTILITIES REGULATORY PROPOSAL 2010-11 - 2014-15

Origin appreciates the opportunity to comment on the regulatory proposal of ETSA Utilities ('ETSA') for the period 2010-11 to 2014-15 (FY11 to FY15).

Origin has been an active retailer of electricity in South Australia since shortly after retail contestability was established in 2003 and has a strong interest in effective regulation of distribution services in that state.

Origin's interests in to the submission of ETSA relate to:

- The classification of metering costs, and
- Proposed capital expenditure increases.

1. Classification of metering costs

In its submission to the Australian Energy Regulator's (AER) *Draft Framework and Approach for ETSA Utilities*,¹ Origin made the argument that the bundling of meter charges is a key barrier to choice in the provision of meters and meter data.

Customers who opt for a type 4 meter to replace their type 6 meter continue to pay the cost of type 6 meters, even though they are no longer receiving these services. Origin argued that a more appropriate classification under the National Electricity Rules (NER) would be to classify metering services as alternative direct control rather than standard direct control.

In its final Framework and Approach for ETSA Utilities,² the AER acknowledged merit in this argument, noting that:

¹ Origin submission to AER's Draft Framework and Approach for ETSA Utilities 2009/10-2014/15, 9 September 2008



This barrier [to entry] occurs as small customers opting for a meter from an alternative provider continue to pay ETSA Utilities for the provision of type 6 metering services (even though they are no longer receiving these services), and so effectively pay for their metering twice.³

and:

Separating these [metering] charges would be more appropriate, as it would remove barriers to entry in metering service markets, leading to more cost reflective price outcomes.⁴

On this basis, the AER decided that the most appropriate classification for metering services in South Australia was as follows:

- ‘fixed’ standard small customer metering services (type 6 metering installations) classified as standard control services, and
- ‘variable’ standard small customer metering services (type 6 metering installations) as alternative control services.

However, Origin notes that in its Regulatory Proposal, ETSA has proposed that the AER reverse its decision on the classification of metering costs. In support of this position, ETSA has pointed to administrative costs associated with a separate classification; the desirability of maintaining an approach similar to the approach already in place in South Australia; and the desirability of maintaining a consistent approach across jurisdictions.⁵

Origin would contend that on the basis of all the criteria under clause 6.6.2 of the NER, the alternative direct control classification is the most appropriate.

ETSA has proposed that metering charges be itemised separately, but maintained under a standard direct control classification. In Origin’s view, this approach is unlikely to be as effective as the alternative direct control classification. Moreover, the question of what is the most appropriate classification does not turn on whether competition could be achieved through a standard direct control classification. Rather, the NER require the regulator to consider the *most* appropriate classification for the services in question, based of all six criteria provided. These criteria are examined, in turn, below.

Clause 6.2.2 of the NER determines the matters the AER must have regard to when classifying a direct control service as standard or alternative:

(1) the potential for development of competition in the relevant market and how the classification might influence that potential; and

(2) the possible effects of the classification on administrative costs of the AER, the Distribution Network Service Provider and users or potential users; and

² Australian Energy Regulator, Final Framework and Approach for ETSA Utilities 2009/10 - 2014/15, 27 November 2008

³ AER, *Final Framework and approach paper ETSA Utilities 2010-15*, November 2008, p.viii

⁴ as per note 3

⁵ ETSA Regulatory Proposal, p.44



(3) the regulatory approach (if any) applicable to the relevant service immediately before the commencement of the distribution determination for which the classification is made; and

(4) the desirability of a consistent regulatory approach to similar services (both within and beyond the relevant jurisdiction); and

(5) the extent the costs of providing the relevant service are directly attributable to the customer to whom the service is provided.

1. The potential for development of competition

Origin would maintain that there is strong potential for greater competition in metering services in South Australia, as the cost of interval meters falls in relation to the cost of accumulation meters.

An indication of the market potential in South Australia is available from examining the market for contestable metering services in New Zealand.

In New Zealand, the adoption of interval meters by retailers and third-party providers has been driven by the commercial benefits that can accrue to customers. As the majority of meters in New Zealand are owned by retailers or third party providers, customers are not charged variable metering costs by their distributor.

In 2008, the Australian Energy Markets Commission (AEMC) commissioned an analysis of the market for contestable metering services in New Zealand.⁶ The study found that “customer demand, competitive pressure and the converging cost structure between AMI and conventional non-AMI meters were the primary drivers of competitive, retailer-led roll outs.”⁷ At the time the study was completed in 2008, it was contemplated that the majority of New Zealand households would have AMI within three years. Announced and current deployment of meters included over 1 million meters in country of some 4 million people.⁸

Furthermore, the study found that once meters were installed competition remained effective, with the installation of a particular meter not creating a barrier to competition among retailers. Meter providers faced strong incentives to make their platform workable for all retailers, since otherwise they risked stranding their asset. Payback frequently occurred over an extended period, meaning meter providers have an interest in keeping the meter in use for the full pay back period, strengthening the incentive for meter providers to develop arrangements with all retailers.⁹

2. Effects of the classification on administrative costs

Origin acknowledges that an alternative classification would involve some cost for the regulator and for ETSA. The AER has evidently assessed the impact on its own costs, since it made the decision to adopt an alternative direct control classification in its *Final Framework and Approach*. In relation to costs imposed on ETSA, ETSA has argued that if all metering services were classified as standard direct control, then ETSA would have no

⁶ K. Murray and M. Black, *Developments in the New Zealand market for Advanced Metering Infrastructure and related services*, July 2008.

⁷ Murray and Black, op cit, p.1

⁸ ibid

⁹ Murray and Black, op cit. p.10



services classified as alternative direct control - thereby simplifying the overall classification and minimising administrative costs.

ETSA will be moving over to a new framework and approach with this determination, creating an opportunity to establish systems to support the alternative direct control classification in Chapter 6 of the NER. There is a strong likelihood this classification will be used by the regulator for metering and other services to promote competition in evolving service markets. The alternative control classification is already proposed for various services in Queensland¹⁰ and Victoria,¹¹ increasing the chances it will be adopted in South Australia in time, as the AER moves towards its medium term goal of uniformity across jurisdictions.

3. The current regulatory approach

The current regulatory approach in South Australia is for all metering services to be bundled in Distribution Use of System charges (DUOS).

Evidently, the AER must in some cases break with the existing classification, in response to changing circumstances. Origin would submit that, as the market for metering services is rapidly evolving as a result of the falling cost of time of use metering, the regulation of these services should reflect these changes.

4. The desirability of a consistent approach across jurisdictions

Origin sees a consistent approach to the classification of services across jurisdictions as a major benefit of the move to a national regulator. Queensland and South Australia are the first jurisdictions to have framework and classification decisions taken under the new rules. As such, there is an opportunity to adopt a consistent approach, by applying alternative direct control classifications to variable metering costs in both states. Origin's submission on the Queensland distributors' regulatory proposals reflects this position.

The approach in New South Wales could be adapted, following the first framework and approach in that state under the new rules. Metering services in Victoria are subject to a derogation, so this is not strictly comparable to the situation in Queensland or South Australia. Outside the framework of the derogation, however, the Victorian approach also involves splitting out metering costs in a comparable way.

5. Extent to which costs are directly attributable to one party

The variable costs of metering can be attributed to those customers who use type 6 meters. The purpose of the proposed classification is to attribute these costs more accurately, in a more cost reflective fashion. ETSA has also noted in its regulatory proposal that there could be some benefit in the unbundling of the metering service components, in the interests of cost reflective pricing.

In summary, barriers to contestable metering impede a competitive process that would otherwise work to reduce the cost of meter provision. Origin strongly supports the AER decision to classify 'variable' standard small customer metering services as alternative direct control services, not only because this would help to promote competition in this

¹⁰ Australian Energy Regulator, Final Framework and Approach for Energex and Ergon, 2010/11-2014/15, August 2008

¹¹ Australian Energy Regulatory Final Framework and Approach for Powercor, Citipower, SPAusnet, Jemena and United Energy, May 2009



evolving market, but also because in Origin’s view this represents the most appropriate classification under the relevant clause of the NER.

II. Capital expenditure increases

Origin notes that ETSA is proposing a significant increase in capital expenditure, from projected average annual expenditure of around \$161 million¹² in FY06 to FY10 to average annual expenditure of around \$463 million¹³ in FY11 to FY15.¹⁴

Origin notes also that in the current period ETSA has had low levels of capital expenditure in relation to the size of its network, when compared to major Australian distribution networks. Some indication of this can be drawn from a simple ratio of capital expenditure in ETSA’s current period to the size of its regulated asset base (RAB).

This comparison is provided in Table 1a, below, which shows the ratio of ETSA’s current capital expenditure to its RAB as 0.05, compared to Energex at 0.12 and EnergyAustralia (EA) at 0.10.

Table 1. Simple ratio of regulatory asset base to capex, for current regulatory period and next regulatory period. ETSA, Energex, Energy Australia¹⁵				
1a. Current regulatory period*				
	year	RAB	capex	ratio
ETSA	FY09	2,842	169	.05
Energex	FY08	5,596	694	.12
EA	FY07	4,914	508**	.10
1b. Forthcoming regulatory period*				
	year	RAB	capex	ratio
ETSA	FY13	3,763	487	.12
Energex	FY13	10,376	1,301	.12
EA	FY13	11,130	1,522	.13
*Note that EA has now entered its next regulatory period, FY10-FY14.				
**Based on approved levels for EA in FY07 \$420mn, added to an annual average of EA’s capex overspend of \$440 mn				
Capex figures are net. Note Energex and ETSA figures for the next regulatory period are proposals only.				

The comparison above is made before normalising for factors such as the shape of the load and customer density - which would tend to imply higher spending for dispersed, peaky networks such as ETSA’s, compared with predominantly urban networks such as those of EA and Energex. Table 1b shows that with the spending proposed for the period FY11 to FY15, ETSA would move to the ratios of the larger networks.

ETSA’s arguments to support a significant increase in capital expenditure include its ageing asset base and pressures from growth in peak demand. 38.9 percent of the increase in capital expenditure is earmarked for expanding capacity to meet peak demand growth, while 21 percent is earmarked for asset replacement.

¹² ETSA Regulatory Proposal, p.97, total of \$805 million over 5 years, nominal

¹³ ETSA Regulatory Proposal, p.108, total of \$2,315 million over 5 years, nominal

¹⁴ These are nominal figures so the increase implied does not account for inflation.

¹⁵ Sources: ETSA: *Regulatory Proposal*, July 2009, pp.97,234; Energex: *Regulatory Proposal*, July 2009, pp. 209,231-2; EA: *EA Initial Regulatory Proposal* June 2008, p.98; AER *Final Determination (NSW)* April 2009, pp.314, 68; IPART *NSW Electricity Distribution Pricing 2004/05 to 2008/09 Final Report*, p.244.



Ideally, asset replacement should be a gradual process. However, to the extent that a higher proportion of assets are now reaching the end of their lives, Origin would expect to see a period of some years where capital expenditure grows at rates higher than growth rates in peak demand and new customer numbers. Nonetheless, Origin would urge the regulator to review the material supporting this capital expenditure proposal in close detail, given the magnitude of the increase. In particular, Origin would draw attention to the points below.

Network capacity utilisation

As noted above, spending on augmentation of the network in response to growth in peak demand accounts for 38.9 percent of the proposed increase in ETSA's capital expenditure (\$2

The utilisation of network assets provides a simple indication of the comparative risk of capacity overload on a particular network. As noted by ETSA, substation transformer utilisation, being the ratio of forecast peak demand to nameplate capacity of substation transformers, is a commonly used measure of network utilisation. ETSA notes that capacity utilisation in the network has been steady at around 60 percent since 2000.¹⁶

A number of factors can influence network capacity utilisation, foremost among these being growth in peak demand and investment in network augmentation. Other things being equal, demand growth should increase utilisation, whereas augmentation should reduce it. Of these, ETSA is making the following projections:

- *Peak demand will grow at similar rates as in the recent past:* ETSA is projecting growth in spatial peak demand in the period 2009-2015 (2.6 percent) similar to that experienced in 2001-2009 (3.0 percent);¹⁷
- *Spending on augmentation is set to increase dramatically:* ETSA is proposing spending \$775.1 million on augmenting capacity in the period FY11-15.¹⁸ \$775 is compares to total (nominal) expenditure on augmentation for the period FY06-10 of under \$250 million.¹⁹

In light of the above, it would be reasonable to assume that network utilisation should drop, compared to the current period. Yet ETSA notes that under its proposal, network capacity utilisation will continue to increase, moving to rates above 70 percent, at the higher end of the acceptable range.

Origin seeks to understand more about the basis for the projection of an increase in network utilisation, given a slight reduction in peak demand growth and a large increase in investment in augmentation. This could involve a more comprehensive discussion of the "one in twenty five year constraint", identified as a primary driver of the high level of expenditure in the augmentation category.

Trajectories for reversing under-investment in ETSA's network

¹⁶ ETSA Regulatory Proposal,

¹⁷ ETSA Regulatory Proposal, p.93

¹⁸ ETSA Regulatory Proposal, p.110

¹⁹ ETSA Regulatory Proposal, Figure 6.6, p.108



Asset replacement accounts for 21 percent of the proposed increase in ETSA’s capital expenditure in FY11-15.

In Figure 6.9, ETSA describes three trajectories for replacing assets, one with an extraordinary peak in capital spending in the next five year period, and two others with more gradual increases.

Origin would note that under ETSA’s preferred trajectory (which is more gradual) capital spending does not exceed \$400 million annually in the period to 2019. However, ETSA states that “replacement expenditure must continue to increase significantly over the next 15-20 years as replacement deferral techniques are exhausted.”

Noting that capital expenditure proposed for FY11-15 would bring ETSA’s ratio of capital expenditure to RAB closer to industry levels (see Table 1b, above), it would be useful to understand in more detail at which point, based on its proposed settings, ETSA sees the trend of under-investment in the network, brought about by an ageing asset base, will have peaked.

Condition monitoring strategies

ETSA notes²⁰ that its condition monitoring strategies are not yet fully implemented and adequate condition-based information is, as yet, unavailable for many asset types. As a result, ETSA is relying on age as a proxy for asset condition in many instances. This is a cause of some concern, given the capital investment programme ETSA is contemplating. Origin would like to understand whether these strategies will be fully implemented in time for the commencement of the next regulatory period.

If you have any questions relating to this submission please contact Steven Macmillan on (03) 8665 7155 in the first instance.

Regards

A handwritten signature in black ink that reads "Bev Hughson".

Bev Hughson
National Regulatory Relationships Manager

²⁰ ETSA Regulatory Proposal p.120